On the other hand, the Air Force has been willing to accept any risks inherent in slowing force expansion in recent years as it delayed growth in favor of buying modern aircraft for existing wings. If the force expansion planned by the Air Force were delayed beyond the next five years, thus maintaining the current 37 wings at least through 1991, the projected manpower and operational support requirements would be decreased over this period as well. Although no savings in budget authority would be realized in 1987 by slowing the expansion, $2.8 billion could be saved by 1991, compared with the Administration's plan. Moreover, a decision to delay expansion now would allow for reductions in aircraft purchases during the next several years (see DEF-03).

DEF-19 PLACE THREE CARRIER BATTLE GROUPS IN RESERVE

Savings from Admin. Request	Annual Savings (millions of dollars) 1987	1988	1989	1990	1991	Cumulative Five-Year Savings
	Savings in Total Federal Budget a/					
Budget Authority	0	70	210	330	420	1,030
Outlays	0	50	140	230	300	720
	Savings in Defense Budget a/					
Budget Authority	0	70	210	330	420	1,030
Outlays	0	60	190	310	400	960

a. Savings in the federal and DoD budgets differ because of the effects of accrual accounting applied in the defense budget to retirement costs of military personnel.

As a major feature of its defense program, the Administration plans to increase the number of aircraft carriers in the Navy's active fleet from 13 to 15. This expansion would also necessitate a commensurate increase in the number of carrier air wings, escort ships, and support ships. Some observers, however, believe that a force of 15 carriers is not required and that 12 would be adequate. A middle ground between these two positions would be to maintain a force of 12 carriers in the active fleet and assign three carriers--along with their associated air wings, escorts (about six per carrier), and support ships--to a special category of the Naval Reserve Force. Although no savings in budget authority would be realized in 1987 by adopting this option, about $1 billion could be saved by 1991, compared with the Administration's plan.

These reserve ships would be manned with reduced crews of active-duty personnel, about 50 percent or less of the ship's normal complement, to perform basic maintenance. The remainder of the crews would be in the reserves. These ships would not go to sea unless mobilized, and assignment to one would count as shore duty in sea/shore rotation. The reserve personnel in this option would be placed in special, nondrilling status. To ensure their proficiency, these reserves would be assigned to the carrier group only for a short period--probably a few years--after they left active duty. Arguably, their skills would not have atrophied greatly in that short period.

Unlike inactive reserve (mothball) ships, these ships would be given periodic overhauls and updated with modern equipment.

This option would also change the Navy's current plans for building to 14 active air wings and two reserve wings to maintaining 12 active wings and, eventually, three reserve wings. (An air wing consists of about 90 aircraft per carrier plus associated equipment and personnel.) Reserve air wings would be manned at current levels, which would permit the substantial peacetime training necessary to maintain flying skills. Carrier training for the reserve wings would be conducted on active-duty ships, as is done now, and reserve wings would continue to receive modern aircraft. This option would not alter current procurement plans, however, since the ships and wings in both the active and reserve forces would be modernized.

DEF-20 RETIRE SOME G-MODEL B-52 STRATEGIC BOMBERS EARLY

Savings from Admin. Request	Annual Savings (millions of dollars) 1987	1988	1989	1990	1991	Cumulative Five-Year Savings
	Savings in Total Federal Budget a/					
Budget Authority	270	840	1,180	1,240	1,300	4,830
Outlays	130	470	780	940	1,050	3,370
	Savings in Defense Budget a/					
Budget Authority	270	840	1,180	1,240	1,300	4,830
Outlays	150	540	880	1,050	1,160	3,780

a. Savings in the federal and DoD budgets differ because of the effects of accrual accounting applied in the defense budget to retirement costs of military personnel.

The bulk of the current strategic bomber force consists of the G and H models of Boeing B-52 aircraft, introduced into the force in the 1960s. Continuing improvements in Soviet air defenses have limited the ability of these bombers to penetrate Soviet airspace. To address this problem, the Administration plans the installation of air-launched cruise missiles on B-52s, the fielding of 100 new B-1B bombers, and introduction of an advanced technology--or "stealth"--bomber (ATB) at a later time.

Cruise missiles are small, unmanned missiles that are highly accurate and can be launched outside Soviet airspace, thus allowing the bomber to remain beyond the range of most enemy air defenses. Cruise missiles are now deployed on 90 of 151 B-52G aircraft, and the 90 newer B-52H aircraft are being modified to carry these missiles. B-52Gs not modified to carry cruise missiles will be transferred from the strategic forces and used as conventional bombers.

The Administration plans to retire B-52Gs that carry cruise missiles in the mid-to-late 1990s, as the ATB is fielded. This option would retire these aircraft by 1988 as the B-1Bs are fielded. Operating and support savings would equal $270 million in 1987 and $4.8 billion over the next five years. These savings include funds that would have been used to modify these aircraft. Although the bomber force would be somewhat smaller than its current size for a few years, numbers would rise somewhat above current levels as the ATB is deployed.

There would be other advantages as well. The SALT II treaty limits to 1,320 the numbers of multiple warhead missiles and bombers carrying air-launched cruise missiles (ALCM); there is a further sublimit of 1,200 on multiple warhead missiles. As long as the United States continues to observe SALT II limits and maintains its other forces as planned, having more than 120 bombers carrying ALCMs would require compensatory reductions in multiple warhead missiles. If older B-52Gs were retired early, all B-52Hs and some B-1s could be modified to carry cruise missiles without triggering reductions in land- or sea-based missiles that would otherwise be mandated. Moreover, retiring these B-52G aircraft early would also reduce demand for tankers for aerial refueling, thus easing the shortfall for that aircraft.

DEF-21 ALTER OPERATION AND MAINTENANCE FUNDING

Savings from Admin. Request	Annual Savings (millions of dollars) 1987	1988	1989	1990	1991	Cumulative Five-Year Savings
Reduce 1987 Funding Request by 10 Percent						
Budget Authority	8,600	9,200	10,000	10,700	11,200	49,700
Outlays	6,700	8,700	9,600	10,300	10,800	46,100
Limit Funding Growth in Each of the Next Five Years						
Budget Authority	11,500	14,000	17,500	21,200	21,600	85,800
Outlays	9,000	12,900	16,300	19,900	20,900	79,000

About 27 percent of 1986 defense appropriations supports the operation and maintenance (O&M) of existing plant and equipment. Part of this account pays for civilian workers. The rest purchases goods and services for maintenance of existing equipment, training, fuel and spare parts, base operations, and many other things. Spending for these activities is commonly referred to as "readiness" spending since it contributes directly to the day-to-day capability of the military forces.

Since 1981, O&M budget authority has increased about 18 percent in real terms. Although some of this growth was needed to support an increase in the Navy and Air Force, much of it, according to DoD, was used to increase the readiness and training of forces that already existed. Current plans call for O&M budget authority to increase over 26 percent in real terms during the next five years. While detailed data are not available, growth is probably higher for O&M purchases than for costs of civilian personnel. Presumably this higher funding stems from the cost of operating increased numbers of forces and of placing current forces at an even higher state of combat readiness and effectiveness.

The planned additions to military forces during this period, however, do not seem to require substantial increases in O&M. Based on five-year force structure and modernization plans submitted by DoD in February 1985, CBO projects an increase in tactical aircraft of 16 percent in the Air Force and 12 percent in the Navy. Numbers of strategic aircraft will remain relatively constant. Navy battle force ships will increase by 12 percent while total Army divisions remain unchanged. CBO estimates that these overall changes will require about 3 percent real increase in O&M spending over the next five years, if the present spending patterns are maintained. Furthermore, current forces are at a very high level of readiness according to DoD.

Reduce 1987 Funding Request by 10 Percent. Beyond the 0.3 percent in 1987 needed for new forces, increases in O&M would presumably be spent for activities to improve current readiness levels. If improvements to date in force readiness were deemed sufficient, growth in O&M could be slowed. In 1986, the Congress limited the budget authority for O&M to about the 1985 level in nominal terms. Sequestration as a result of the Balanced Budget Act, however, reduced this by another 4.9 percent. Reducing the O&M funding request by 10 percent in 1987--about the same percent reduction voted by the Congress in 1986--and then allowing it to increase at rates proposed by the Administration in subsequent years would save $8.6 billion in budget authority in 1987 and a total of $49.7 billion over the next five years. In 1987 this might require reducing operating tempos relative to today's level, unless operating and maintenance efficiencies could be realized. This reduction, however, would be offset by the increased real spending proposed in later years. CBO cannot specify in detail the effects of such a limit because of the large number of O&M projects, each of which could be affected differently.

Limit Funding in Each of the Next Five Years. Alternatively, the Congress could choose to hold O&M budget authority at the 1986 level in nominal terms for one year, followed by zero real growth in subsequent years. This would save $11.5 billion in budget authority in 1987 and $85.8 billion over the next five years. As with the previous approach, operating tempos might have to be reduced in 1987. But, unlike the previous approach that allowed real increases in O&M beyond 1987, the services would probably not be able to return to the 1986 operating levels unless other changes were made--such as a transfer of more forces to the Reserves (see, for example, DEF-19). Furthermore, under this approach, the services would not have increased funds to operate new forces unless they further reduced the operating tempos of existing forces. Thus, adopting this alternative might force the services to choose between maintaining readiness and force expansion in subsequent years.

DEF-22 RESTORE FORMER ENLISTED-OFFICER RATIOS

Savings from Admin. Request	1987	1988	1989	1990	1991	Cumulative Five-Year Savings
	Annual Savings (millions of dollars)					
Savings in Total Federal Budget a/						
Budget Authority	102	372	714	954	1,035	3,177
Outlays	70	259	504	682	747	2,262
Savings in Defense Budget a/						
Budget Authority	106	388	745	988	1,075	3,302
Outlays	103	380	734	981	1,072	3,270

a. Savings in the federal and DoD budgets differ because of the effects of accrual accounting applied in the defense budget to retirement costs of military personnel.

The ratio of enlisted personnel to officers in the Armed Forces could be increased, possibly with little loss of military effectiveness. Since its post-Vietnam peak in 1977, the ratio has declined from 6.5 enlisted personnel for every officer to about 6.0 per officer in 1985. (Between 1964 and 1985, the ratio decreased from 6.8 to 6.0.) The sharpest drop has occurred in the Army; its ratio has fallen from 7.0 enlisted personnel per officer in 1977 to 6.2 in 1985. The Department of Defense manpower projections imply that, without active policy changes, the overall ratio will remain constant at its new level through 1989.

This declining ratio does not appear to reflect changing military requirements. Some military missions, such as training, require fewer enlisted personnel per officer than other missions (general purpose combat forces, for example). But the decline in the overall ratio is not explained by shifts in major military missions. Nor does it appear that increases in the technical complexity of weapons systems justify having more officers relative to enlisted personnel. And there is no evidence that the declining ratio is a response to overall budgetary trends or pay levels. Instead, the ratio has fallen steadily for the past nine years, during which time both military pay and total defense spending have first fallen and then risen in comparison with civilian pay and the overall level of GNP.

In principle, each of the services plans the mix of officers and enlisted personnel at a highly detailed level and then aggregates its plans to yield overall personnel totals. Apart from equipment modernization, this process might produce a declining enlisted-officer ratio as the result of such considerations as maintenance of a larger mobilization cadre or substitution of senior enlisted and officer supervisory personnel for junior enlisted forces. In the absence of specific explanations for the falling enlisted-officer ratio, however, the persistent tendency of the ratio to decline might indict a need to impose aggregate limits. Such limits would also be consistent with Administration efforts to reduce the number of federal civilian personnel at middle and senior levels.

To meet such overall constraints while reexamining requirements for officers, the services could recruit fewer officers, leaving their enlisted recruiting plans untouched. If, over the next three years, the numbers of officers were reduced by 17,000, then by 1989 the ratio would be about 6.25 enlisted personnel per officer. This action would reverse about half the decline in the enlisted-officer ratio that occurred between 1977 and 1985. Such a policy would reduce manpower levels modestly in 1987. It would save $106 million in defense budget authority in 1987 and a total of $3.3 billion over the next five years, compared with the Administration's plans. In addition, such a limit might result in slower promotions within officer ranks and thus generate modest additional savings in pay and allowances beyond those estimated here.

Savings would be considerably smaller, of course, if the total numbers of military personnel were maintained at planned levels. In that event, the ratio of enlisted to officer personnel could be reduced by substituting enlisted personnel or lower-ranking warrant officers for commissioned officers.

DEF-23 IMPOSE FEES FOR MILITARY OUTPATIENT CARE

Savings from Admin. Request	Annual Savings (millions of dollars)					Cumulative Five-Year Savings
	1987	1988	1989	1990	1991	
Budget Authority	95	100	110	120	130	555
Outlays	75	95	104	115	125	515

Beneficiaries of the military medical care system pay nothing for their visits to military physicians. This option would charge those outpatients who are not on active duty (dependents of active-duty personnel and retired military personnel and their dependents) for each visit. Charges would be linked to ability to pay; enlisted families would pay $5 a visit, officers' families, $10. Total charges would be limited to $100 a year for each enlisted family member and $200 for each officer family member. These charges would increase yearly at the same rate as the daily charge for inpatient medical care, which dependents already must pay. Charging outpatients would help DoD defray the $58 it spends on average for each outpatient visit and would save at least $95 million in budget authority in 1987 and $555 million over the next five years. Administrative costs, which would offset part of this revenue, are reflected in the annual savings above.

Besides raising revenue, charging fees could also cut back on non-active duty outpatient visits. People overuse free medical services, thus contributing to overcrowding in military clinics. To get timely care, many beneficiaries turn to the more costly Civilian Health and Medical Program of the Uniformed Services (CHAMPUS). DoD could benefit from reduced overcrowding by attracting back to military facilities many outpatients who now use CHAMPUS; less recourse to CHAMPUS could save another $625 million through 1991. (These savings are not included above because they are less certain.) Or DoD could benefit from reduced overcrowding by channeling newly freed resources into other areas.

Because medical care is an important part of military compensation, military families would view outpatient charges as an erosion of benefits. Recruitment and especially retention could suffer, although the parallel trend in civilian medicine toward patients bearing a larger share of their medical costs might limit military dissatisfaction. Moreover, the small annual maximum charges should help to mitigate any adverse effects. Nor should a fee significantly harm health, a concern of some, since evidence shows that people at ages and income levels typical of military beneficiaries seek necessary medical care even when they share the costs.

DEF-24 SELECTIVELY RAISE MILITARY PAY

Savings from Admin. Request	Annual Savings (millions of dollars) 1987	1988	1989	1990	1991	Cumulative Five-Year Savings
Savings in Total Federal Budget a/						
Budget Authority	2,300	2,375	2,455	2,545	2,630	12,305
Outlays	1,570	1,625	1,665	1,705	1,745	8,310
Savings in Defense Budget a/						
Budget Authority	2,360	2,435	2,520	2,615	2,705	12,635
Outlays	2,325	2,435	2,520	2,610	2,705	12,595

a. Savings in the federal and DoD budgets differ because of the effects of accrual accounting applied in the defense budget to retirement costs of military personnel.

Under current law, military personnel will receive an annual pay raise in October 1986. The Administration proposes a 4 percent increase, which should keep pace with wage increases in the private sector. But since everybody in active-duty and reserve service receives the same treatment, this across-the-board approach diffuses the incentives of pay raises. Selectively raising the pay of active-duty personnel--through higher special reenlistment bonuses--could meet many military needs at less cost. For example, substituting the selective increase described below for the proposed 4 percent raise would save $2.3 billion in budget authority from the Administration's request in 1987 and $12.3 billion over the next five years. (Annual raises after 1987 are assumed to keep pace with those in the private sector, but contain no adjustment to recoup the loss of an across-the-board raise in 1987.)

The services can most strongly influence retention in their enlisted career forces (personnel with more than four years of active-duty military service) by directing pay increases to the first and second reenlistment points, which usually occur in the fourth through tenth years of service. Before the fourth year, personnel are serving in their first term and pay does little to affect retention. After the tenth year of service, rates of reenlistment rise markedly because of the opportunity to retire at 20 years; moderate pay changes would affect those rates only marginally.

The services already pay selective reenlistment bonuses of up to $30,000 (though usually much less) to service members with critically needed skills who reenlist for at least three years during the fourth to tenth years. These bonuses are currently projected to cost $568 million in 1986. To produce about the same effect on the first- and second-term reenlistments as raising pay 4 percent across the board, spending on bonuses would have to increase about $225 million in 1987. Since eliminating the raise would save $1.8 billion, net savings over the Administration's request would amount to $1.6 billion.

One drawback to this option is that it would erode some of the recruiting success of recent years, because recruits and junior personnel would receive no raise in pay in 1987. Nonetheless, recruitment should remain well above historical levels, at least through 1988.

In addition, those personnel not receiving a selective pay raise might well feel unfairly treated. The more senior among them could become upset about "pay compression" since senior personnel might not enjoy as great an advantage in pay as the people under their supervision. Although service members unhappy about the fairness of their pay might not depart in large numbers, they could lose motivation and become less productive. Officers also would not receive any additional selective pay under this approach. Although their recruitment and retention has been good in recent years, officers could be adversely affected. Still, officer losses are not likely to be severe under this option.

These drawbacks suggest that substitution of a selective pay raise for an across-the-board increase should be used sparingly, mainly as a way to hold down costs. This option proposes such a substitution just for 1987, with across-the-board increases returning in later years. Indeed, in the long run, annual military pay raises will have to keep pace with increases in private-sector pay if the services are to avoid losing their best people.

DEF-25 IMPLEMENT PROPOSED CHANGES IN MILITARY RETIREMENT

Savings from Admin. Request	Annual Savings (millions of dollars) 1987	1988	1989	1990	1991	Cumulative Five-Year Savings
			Savings in Total Federal Budget a/			
Budget Authority	134	411	704	993	1,243	3,485
Outlays	0	-1	-5	-16	-27	-49
			Savings in Defense Budget a/			
Budget Authority	134	411	704	993	1,243	3,485
Outlays	134	411	704	993	1,243	3,485

a. Savings in the federal and DoD budgets differ because of the effects of accrual accounting applied in the defense budget to retirement costs of military personnel.

In 1987 the military retirement system will provide benefits for about 1.4 million people at a cost of over $18 billion. Changes to reduce the cost of this system and to improve its incentives for efficient management of military personnel have been recommended by at least nine major studies since 1969. In the 1986 DoD Authorization Act, the Congress took a major step toward implementing those recommendations by mandating a reduction of $2.9 billion--16 percent--in the annual accrual cost of military retirement (using the cost methodology in effect for fiscal year 1986) and by directing the Department of Defense to propose structural changes in the system to yield those savings. In November 1985, DoD responded by offering two alternative proposals consistent with the Congressional mandate, although it does not recommend any change in military retirement and has not assumed any savings in its budget for the 1987-1991 period. Those proposals are now awaiting Congressional action.

This option illustrates the savings that would result from enactment of one of the DoD proposals, called the "Combination Plan." Changes to the military retirement system, which would apply only to members entering service after enactment of the new plan, would include reductions in the basic annuities of military retirees. For example, the annuity of a retiree who left service after 20 years would be 44 percent of the retiree's "high-three" average basic pay, rather than 50 percent as under the current system. In addition, the DoD proposal would diminish inflation protection for retirees. Instead of the full cost-of-living adjustments (COLAs) provided under the current system, retirees would receive COLAs of one percentage point less than the change in the Consumer Price Index (CPI). At the fortieth anniversary of entry into service, however, retirees' annuities would be recomputed to the level they would have reached under full COLAs, following which future COLAs would continue at one percentage point below the CPI. The purpose of this one-time restoral is to protect, at least partially, the value of retirement pay during old age.

Enacting the Combination Plan would save an estimated $134 million in budget authority and outlays in the defense budget in 1987 and $3.5 billion from 1987 through 1991, but as explained below, it would add $50 million in total federal outlays through 1991. (The difference between defense and federal outlays is the result of accrual accounting for military retirement. Accrual savings in 1987 are much lower than the 1986 target of $2.9 billion because of changes in the costing methodology adopted by the DoD Board of Actuaries.) All savings are relative to the Administration's proposed budget and assume that the Combination Plan would be enacted during 1986 and applied only to personnel entering military service in fiscal year 1987 or later.

Although DoD presented the Combination Plan as one way of complying with the Congressional mandate, the department does not advocate it. DoD contends that any reduction in future retirement benefits would induce premature retirements and so reduce the size of the military career force (defined to include those with four or more years of service). CBO estimates that the proposed changes would eventually leave the career force about 3 percent smaller than it would be under continuation of the current retirement system. But the change should just slow future growth rather than reduce it below today's level. If necessary, even this slowed growth could be offset by increases in other incentives, such as reenlistment bonuses for service members in those skills in which retention of experienced people is most needed. This possible cost increase was not included in the above table, but it would not offset more than a small part of the total savings.

CBO's estimates of the savings from the Combination Plan reflect the accrual accounting procedures that were first implemented in the budget for fiscal year 1985. Under these procedures, the accrual costs of future retirement liabilities, rather than actual current payments to retirees, appear as budget authority and outlays in the defense budget and budget authority in the total federal budget. Accrual accounting is designed to show the costs of future retirement in today's defense budget, so that retirement costs will be considered in decisions made today, even though the actual expenditures will not occur for many years. Actual payments to retirees still determine federal outlays, however.

For the 1985 and 1986 budgets, DoD calculated the accrual charges for military retirement by projecting the cost for an entering group of new service members (referred to as their "Entry-age Normal Cost"). Under this procedure, savings from the Combination Plan would have been calculated as $2.9 billion, the amount mandated by the Congress. In effect, this procedure ignored the fact that most personnel now in service would have continued to be covered under the current military retirement system rather than under the Combination Plan.

Beginning with the 1987 budget, however, DoD's Board of Actuaries decided to calculate the accrual charge for military retirement based on the weighted average normal costs for all personnel currently in service. CBO's estimates in the above table incorporate this methodological change. Assuming that the Combination Plan was enacted in 1986 and applied to all members entering the service in 1987 or later, only first-year personnel would be covered by the new plan during fiscal year 1987. For these people, the savings in retirement accrual charges would be 16 percent. For all other personnel, however, there would be no savings. The first-year (1987) reduction in DoD budget authority, therefore, would be only a small fraction of the $2.9 billion savings that would be realized once all service members were covered by the Combination Plan. In 1988 first- and second-year members would be covered by the Combination Plan, so--as shown in the table--accrual savings would be roughly twice as great as in 1987. Further increases in annual savings would arise as the new plan applied to larger numbers of service members.

Over the five-year period, the Combination Plan would cause a large reduction in defense and total budget authority and defense outlays. These reductions in budget authority correspond to the savings in retirement outlays that the government eventually would realize under the Combination Plan. Under accrual accounting, however, DoD outlays for the accrual costs are cancelled out elsewhere in the federal budget, so federal outlays continue to reflect actual payments to retirees. These payments would begin to fall only after members covered by the Combination Plan reached retirement.

Estimated outlays in the federal budget would also be affected by changes in the overall composition of the military forces. As noted above, the Combination Plan would eventually lead to a smaller military career force and, thus, to associated changes in personnel costs. Military pay and allowances would fall somewhat with the change to a slightly more junior force, but these reductions would be more than offset initially by higher costs of training and recruiting. CBO's estimates assume that these changes in associated personnel costs would phase in over the first five years after enactment of the Combination Plan. Under this assumption, the net five-year increase in federal outlays would be $50 million.

ENTITLEMENTS AND OTHER MANDATORY SPENDING

This category presents 24 options that would either reduce outlays for entitlements and other mandatory spending or increase general and earmarked revenues. ENT-01 through ENT-11 deal with health care programs. ENT-12 through ENT-18 discuss alternatives for reducing net federal outlays for Social Security and other retirement and disability programs. ENT-19 through ENT-24 deal with other entitlements, including means-tested and non-means-tested benefits and grants to state and local governments.

Several of the options are substitutes for one another. For example, ENT-07 through ENT-09 represent three alternative ways of increasing beneficiaries' contributions to Medicare, with contrasting effects on beneficiaries at different income levels. Also--as in ENT-03 and ENT-12, for instance--the individual summaries describe more than one specific policy alternative. The savings for the separate options--or from the variants within a single option--should not be added together to arrive at a total because, in general, they could not be combined.

ENT-01 TAX EMPLOYER-PAID HEALTH INSURANCE

Addition to CBO Baseline	Annual Added Revenues (billions of dollars) 1987	1988	1989	1990	1991	Cumulative Five-Year Addition
Tax Some Employer-Paid Health Insurance						
Income Tax	2.5	4.2	5.2	6.4	7.7	26.0
Payroll Tax	1.0	1.7	2.1	2.5	3.0	10.3
Total	3.5	5.9	7.3	8.9	10.7	36.3
Tax Employer-Paid Health Insurance But Allow a Credit for Employer and Employee Contributions						
Income Tax a/	-0.1	0.7	1.1	1.5	1.8	5.0
Payroll Tax	7.1	10.1	11.3	12.5	13.8	54.8
Total	7.0	10.8	12.4	14.0	15.6	59.8

a. Negative revenues represent the net effect of additional revenues from counting employer-paid health insurance as part of taxable income and reduced tax payments from credits for employer and employee contributions.

Employees do not pay taxes on income received in the form of employer-paid health care coverage. This exclusion will reduce 1987 income tax revenues by approximately $26 billion and Social Security payroll tax revenues by an additional $9.5 billion. Moreover, the recent onset of "cafeteria plans" and "flexible spending accounts" (FSAs) raises the amount of health insurance payments escaping taxation (see REV-21).

Tax Some Employer-Paid Health Insurance. One proposal to limit the exclusion would be to treat as taxable income any employer contributions (including those in cafeteria plans and FSAs) that exceed $200 a month for family coverage and $80 a month for individual coverage (in 1987 dollars), with these amounts indexed to reflect future increases in the general level of prices. This proposal would raise income tax revenues by $26 billion and payroll tax revenues by $10.3 billion over the 1987-1991 period. Including employer-paid health care coverage in the Social Security wage base, however, would lead to increased outlays on benefit payments that would offset most of the added payroll tax revenues from this option over the long run.

Proponents of this approach point out that it would eliminate the tax incentive to purchase additional coverage beyond the ceiling, which reduces incentives to economize in the medical marketplace and increases the upward pressure on medical care prices. Over the long run, indexing the limits would prevent their erosion by inflation. Finally, they note that the Congress has already limited the exclusion for employer-paid group life insurance (see REV-21).

Opponents object to limiting the tax subsidy, pointing to the difficulty of determining just when extensive coverage becomes excessive. They further argue that a uniform ceiling would have uneven effects, since a given employer's contribution purchases different levels of coverage depending on such factors as geographic location and the demographic characteristics of the firm's workforce. Finally, the indexing provision of this proposal would lead to declining subsidies for employer-paid health insurance in the long run, if health insurance costs continue to rise faster than the general level of prices. This is of concern to people who argue that these subsidies to private-sector benefits help avoid the need for public provision of the same benefits.

Tax Employer-Paid Health Insurance But Allow a Credit for Employer and Employee Contributions. Another option would be to treat all employer-paid health insurance premiums as taxable but offer a tax credit of 25 percent for health insurance premiums up to the amounts described above for family and individual coverage. The credits would be available to taxpayers regardless of whether the coverage was paid for or sponsored by an employer. At this credit percentage and with these premium ceilings, the proposal would increase income tax revenues by $5 billion and payroll tax revenues by $54.8 billion over the 1987-1991 period. As under the first option, increases in Social Security outlays would offset most of the added payroll tax revenues in the long run.

Proponents of this approach argue that, in addition to eliminating the tax incentive to purchase health insurance above the limits, the subsidy would be made available to taxpayers without regard to their employment status. Moreover, the subsidy per dollar of eligible health insurance coverage purchased would not vary with taxpayers' incomes. Others, however, object that the benefits of a tax credit would not be available to low-income individuals and families who have no liability under the federal personal income tax. Although benefits of the credit could be extended to these people by making it refundable, doing so would substantially reduce the net revenues discussed above.